U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation	)	MM Docket No. 93-215
	)	
and	)	
	)	
Adoption of a Uniform Accounting System for Provision of Regulated Cable Service	)	CS Docket No. 94-28

Reply Comments of the Chief Counsel for Advocacy of the United States Small Business Administration on the Further Notice of Proposed Rulemaking

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I. *Introduction*

In October of 1992, the United States Congress enacted, over a veto, the Cable Television Consumer Protection and Competition Act (Cable Act).[1] The Cable Act was passed to reduce the perceived abuses of customers and competitors by cable operators.

Implementation of the Cable Act required approximately 25 separate rulemakings some of which are still ongoing. The

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[1] Pub. L. No. 102-385, 106 Stat. 1460 (1992) (codified, as amended at 47 U.S.C. §§ 521-59).

instant rulemaking was initiated in 1993[2] to develop an alternative to the benchmark pricing regime developed by the Commission in MM Docket No. 92-266 for the regulation of rates.[3]

The Cable Act provides for bifurcated regulatory power over rates. Local franchising authorities[4] are authorized to regulate the rates of basic cable service[5] according to the standards prescribed by the Commission.[6] The FCC is empowered

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[2] In the Matter of the Cable Television Consumer Protection and Competition Act of 1992 -- Rate Regulation, MM Docket No. 93-215, Notice of Proposed Rulemaking (July 16, 1993), *summarized in* 58 Fed. Reg. 40,762 (July 30, 1993).

[3] In the Matter of Implementation of Section of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, MM Docket No. 92-266, Report and Order (May 3, 1993). The benchmark rate regulatory process was revised significantly at a Commission meeting on February 22, 1994. Second Order on Reconsideration and Fourth Report and Order, MM Docket No. 92-266.

[4] Under the Cable Communications Policy Act of 1984, Pub. L. No. 98-549, 98 Stat. 2870 (codified as amended at 47 U.S.C. §§ 521-59) all cable operators must obtain a franchise from an appropriate local governing authority. The Cable Act does not modify that requirement.

[5] Basic cable service is defined as any tier of service that includes the transmission of local over-the-air broadcast signals, public access channels, and any government-owned channels.

[6] The FCC was directed to develop a regulatory regime to ensure that rates charged for basic cable service are reasonable.

to regulate the rates of cable programming services[7] to ensure that those rates are not unreasonable.[8]

In developing a rate regulatory regime, the Commission determined that normal cost-of-service[9] ratemaking would not be the least burdensome methodology. This conventional ratemaking system would entail individual rate calculations for some 11,000 cable systems by some 20,000 franchising authorities in addition to 11,000 separate determinations by the FCC staff for cable programming service.

Rather than utilizing conventional ratemaking, the Commission adopted a concept from its regulation of dominant

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[7] Cable programming services are all cable programming services other than those programs that constitute basic service or are offered on an a la carte (the most common being premium movie channels such as HBO or Showtime) or pay-per-view basis. The Commission has constantly revised and continues to rework its rules concerning what services and tiers can be regulated and what services and tiers constitute a la carte programming.

[8] The FCC determined that the same rate regulatory principles should apply to both basic and cable programming service. MM Docket No. 92-266, Report and Order at ¶ 389. Subsequent decisions by the Commission have not changed this conclusion.

[9] Under cost-of-service or rate-of-return regulation, a regulated entity submits a rate request to a regulatory agency along with extensive cost data. From this information, a rate for the service is calculated that ensures the entity will recover all costs for providing the service and earn a specified return on its investment.

common carriers -- price caps.[10] In the context of cable service, the FCC found that cable rates for systems which did not face effective competition were 17 percent higher than those that did. MM Docket No. 92-266, Second Order on Reconsideration at ¶ 105. These benchmarks are then modified annually to take account of inflation, programming costs (which are passed through to customers), and certain other costs beyond the control of the operator. MM Docket No. 92-266, First Report and Order at ¶¶ 223-57.

While benchmarks and price caps represent the primary scheme for rate regulation, the Commission concluded that cost-of-service showings should be permitted for operators that cannot operate profitably under the benchmark standards. *Id.* at ¶¶ 262-64, 400-02. According to the FCC, this backstop is necessary because the benchmarks are derived from general industry data and a specific system's costs may not be accurately reflected in this

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[10] Rates charged by common carriers for interstate interexchange service are subject to regulation pursuant to Title II of the Federal Communications Act of 1934, 47 U.S.C. §§ 151-609. Dominant common carriers subject to such rate regulation include AT&T (the only interexchange carrier so designated) and all local exchange carriers. Other carriers must file tariffs with the Commission but their rates are not subject to regulation. MCI v. AT&T, 62 U.S.L.W. 4527, 4532 (1994).

Price caps provide an alternative means by which the FCC can ensure reasonable rates -- the same polestar guiding the regulation of cable operators. The touchstone of price caps is the imposition of price limits on baskets of services rather than mandating a tariff that will provide a specific rate of return for the carrier. The FCC adapted this process to cable operations with the establishment of programming and equipment baskets. MM Docket No. 92-266, Report and Order at ¶¶223-41.

data. *Id.* at ¶ 262.[11] The Commission initiated this docket to develop regulations that permit cable operators to make conventional cost-of-service showings in an effort to demonstrate that their costs differ from the costs that undergird the benchmarks.

The Office of Advocacy filed substantial comments with the Commission in response to that proceeding. Among other things, the Office of Advocacy requested the use of average cost schedules and even the establishment of an organization similar to the National Exchange Carrier Association (NECA) for smaller cable operators.

In the First Report and Order in this docket, the Commission did not adopt the suggestions of the Office of Advocacy. However, the Commission has issued this further notice of proposed rulemaking (FNPR), In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 -- Rate Regulation, MM Docket No. 93-215 and CS Docket No. 94-28, Report and Order and Further Notice of Proposed Rulemaking (March 30, 1994), in an effort to obtain more

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[11] In this respect, the price cap model for cable operators is very different than the price caps utilized for local exchange carriers. In the adoption of price caps for telephone companies, the Commission had constantly regulated their rates and determined that the current rates charged by the exchange carriers were reasonable. Since rates for cable operators were unregulated, the FCC could not use, as the basis for the benchmarks, the current rates charged by cable operators.

information on the utility of allowing cable operators to use average cost schedules. *Id.* at ¶¶ 330-33. The FCC also seeks comments on the overall rate-of-return for cable operators,[12] and whether a productivity offset should be instituted for cable operators. *Id.* at ¶¶ 314-23. Finally, the FNPR is being conducted in conjunction with another cost survey by the Commission in an attempt to obtain a more accurate reflection of the costs faced by the cable industry and in particular smaller operators. *Id.* ¶ 334.

The Office of Advocacy has reviewed the comments filed in the FNPR. The Office of Advocacy agrees with the comments offered by local exchange carriers that the rate regulation methods developed by the FCC for common carriage may be appropriate for cable operators. However, the Office of Advocacy does not believe those comments go far enough in distinguishing the two industries or proffering an appropriate regulatory regime for small cable operators. The Office of Advocacy opines that the rate regulation models developed for smaller local exchange

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[12]The Office of Advocacy takes no position on the rectitude of the Commission's initial determination that a reasonable rate of return for cable operators is 11.25%. FNPR at 305. However, the Office of Advocacy notes that small business in general and small cable operators in particular (due to rate regulation) have difficultly attracting capital. As a result, these small businesses face substantially greater costs to acquire capital than large businesses. The Office of Advocacy strongly recommends that the Commission delay adopting any rate of return for small cable operators until it has completed the cost study of these operators.

carriers provides the most apt mechanism for regulating small cable operators.

II. *Definition of Small Cable Operator*

In earlier comments filed in this proceeding, the Office of Advocacy noted that the 1,000 subscriber standard in the Cable Act does not provide an adequate definition of small operator. The Commission agreed with that assessment and developed two separate definitions of "small" within the context of cable operations.

In the Second Reconsideration Order, the Commission defined a small operator for purposes of providing transition relief from the full 17% rate rollback.[13] The FCC defined a small operator as systems which are owned by operators with a subscriber base of 15,000 or less as of March 31, 1994 and which are not affiliated with or controlled by larger operators. The FCC staff calculated that this translates into systems with a revenue of approximately $3.6 to $4.5 million from regulated service. MM Docket No. 92-266, Second Reconsideration Order at ¶ 120. The Commission

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[13] The FCC found that smaller operators may face higher than average costs and they may not be able to financially absorb, in a short period of time, the full 17% reduction. The Commission permitted these entities to cap their rates at March 31, 1994 levels until the FCC finished a further study of operator costs. Since operators had been subject to a rate freeze prior to the issuance of the Second Reconsideration Order, small operators have had rates frozen at September 30, 1992 rates.

adopted that standard because it reasoned that operators who exceed that revenue target are sufficiently large that they will be able to obtain financing from conventional sources should the rate rollback prove detrimental to their finances. *Id.*

The Commission also defined a "small multiple system operator"[14] for purposes of providing yet a different type of regulatory relief.[15] The Commission affords this rate relief to any small system (one with less than 1,000 subscribers) if it is independently owned or is affiliated with a multiple system operation that has a total of less than 250,000 subscribers in which no system is larger than 10,000 subscribers, and the average system size is 1,000 or fewer subscribers. *Id.* at ¶ 216. The Commission adopted this standard because it tailors the relief to those operators that face the highest administrative costs of compliance due to the large number of small systems that they own.[16]

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[14] Multiple system operators are those cable operators that own and operate more than one system. The two categories established by the FCC are not mutually exclusive. There are a number of cable operators that own more than one system yet have a total subscriber base of less than 15,000.

[15] The transitional relief for these multiple system operators would be in the form of streamlined rate reductions of 14% until the Commission finishes its study of cable system costs.

[16] The Office of Advocacy estimates that very few cable operators satisfy these criteria.

The Office of Advocacy commends the FCC for developing relief for "small" cable operators. However, the Office of Advocacy still maintains that the Commission's standards do not provide an adequate definition of small business. Further, the Office of Advocacy believes that the Commission must comply with the requirements of the Small Business Act in developing an appropriate definition of small business for the purpose of providing cost-of-service standards for small operators. Finally, the Office of Advocacy recommends that the FCC look to its regulation of local exchange carriers for an appropriate definition of small business.

A. Current Definitions are Inadequate

The FCC's definitions of "small" are inadequate because many operators that do not fit these definitions face the same administrative and resource constraints as those systems that fall within the definitions adopted in the Second Reconsideration Order. Data available from the Small Cable Business Association demonstrates that firms beyond the 15,000 subscriber limit face higher programming costs and significantly higher wiring costs per subscriber.[17] Given the size of these firms, many have difficulty obtaining financing despite the Commission

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[17] Many small operators provide service in rural areas where population densities prohibit low-cost wiring of franchise areas.

unsubstantiated claims to the contrary.[18] Finally, these firms do not have access to the administrative, financial, or technical assistance needed to comply with the regulatory issuances stemming from the enactment of the Cable Act. The Office of Advocacy strongly suggests that the Commission develop new size standards to be applied to firms seeking cost-of-service regulatory treatment.

B. FCC Must Follow the Small Business Act

Prior to the enactment of the Small Business Credit Enhancement Act, § 3(a) of the Small Business Act defined a small business as one that was independently owned and operated and not dominant in its field. The Act also authorized the Administrator of the Small Business Administration (SBA) to promulgate size standards for various classes of businesses in order to carry out the purposes of the Small Business Act.[19] Under the Act, federal agencies were permitted to craft their own size standards for their own regulatory programs and for conducting analyses

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[18] The Office of Advocacy need not perorate on the significant number of initiatives undertaken by the Small Business Administration banking regulators, and the Federal Reserve to ease capital access for small businesses.

[19] Those size standards can be found at 13 C.F.R. § 121.601. The standards were recently adjusted for inflation. 59 Fed. Reg. 16,513 (April 7, 1994).

pursuant to the Regulatory Flexibility Act, 5 U.S.C. §§ 601-12 (RFA).[20]

The passage of the Small Business Credit and Business Opportunity Enhancement Act[21] amended § 3(a) and mandated that the SBA's size standards were to apply to fulfill the purposes of the Small Business Act or any other act. Two exceptions applied: 1) if the other statute provides a different small business definition, such as the Family and Medical Leave Act of 1993;[22] or 2) the head of an agency determines that the size standards promulgated by the SBA are inappropriate for a particular regulatory program and follows the procedures set forth in § 3(a)(2) for crafting a different definition of small business.

The Cable Act did not contain a small business definition. The only statutory reference to size in the Act was to define a small system as one with 1,000 or fewer subscribers. 47 U.S.C. § 543(i). Since system size bears no relation to firm size,[23]

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[20] The RFA authorizes agencies to develop their own size standards but only after consultation with the Chief Counsel for Advocacy. 5 U.S.C. § 601(3).

[21] Pub. L. No. 102-366, 106 Stat. 986 (1992).

[22] Pub. L. No. 103-3, 107 Stat. 7 (1993). The Act exempts any business with less than 50 employees from coverage.

[23] The Commission's development of a cap on the size of firms eligible for streamlined rate relief evidences FCC recognition that small systems may be owned by very large businesses.

the definition of a small system is not tantamount to a definition of a small business.

Nor did the Commission adopt the SBA's definition of a small cable operator. At the time of the issuance of the Second Reconsideration Order, the SBA defined a small cable operator as one that has $7.5 million in gross revenue. That standard was raised shortly after the release of the Second Reconsideration Order to $11.0 million.

The FCC can develop a different size standard. However to do so, the Commission has to issue a proposed standard, seek notice and comment,[24] and obtain the approval of the SBA. In addition, § 3(a)(2) requires adoption of a gross revenue standard for non-manufacturing businesses. The Office of Advocacy strongly urges the FCC to follow these simple procedures for developing a size standard to provide regulatory relief in the cost-of-service proceeding.

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[24] The Office of Advocacy doubts that either the original notice in this docket or the FNPR would satisfy the requirement that the development of a size standard be the "logical outgrowth of the preceding notice and comment process." Weyerhauser v. Costle, 590 F.2d 1011, 1031 (D.C. Cir. 1978). The Office of Advocacy strongly recommends that the Commission reissue the FNPR specifically requesting comment on the definition of "small" for purposes of the ongoing cost studies and the development of any permanent regulatory changes for "small" cable operators.

C. Common Carrier Definitions are Appropriate

Although the FCC should follow the procedures limned in the Small Business Act with respect to developing a small business definition, the Commission may not have to look far for appropriate size definitions. The Commission has established a wide variety of standards with respect to the regulation of local exchange carriers. The Office of Advocacy believes that the logical breakdown of those categories can be directly applied to cable operators.

Although there are differences between cable operators and local exchange carriers,[25] the regulation of rates mandated by the Cable Act strips away many of those distinctions. The Act requires the Commission to regulate rates so that they are reasonable.[26] In developing these regulations, the Commission is required to distinguish between costs for basic cable programming service, consider the costs associated with program acquisition and transmission of each type of service, allocate

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[25] Local exchange carriers are common carriers and have no control over the messages transmitted on their lines. Cable operators "engage in and transmit speech, and they are entitled to the protection of the speech and press provisions of the First Amendment." Turner Broadcasting Sys. v. FCC, 62 U.S.L.W. 4647, 4650-51 (1994). While this represents the primary distinction, there are numerous technical differences between the two types of carriers.

[26] The reasonability standard is also used in Title II of the Federal Communications Act of 1934 (Communications Act) for the regulation of wireline common carriers. 47 U.S.C. § 201(b).

costs between the two types of services, and ensure that operators obtain a reasonable profit.[27] 47 U.S.C. § 541(b-c). Thus, little distinction exists in the rate regulatory aspects of the Cable Act and Title II of the Communications Act and the Commission concurs in that finding by adopting many of its Title II mechanisms for cable rate regulation.

The FCC's regulation of local exchange carriers makes significant distinctions among firms of varying size. According to the Commission, "enormous differences exist among them [local exchange carriers]...."[28] The FCC also noted that "LECs [local exchange carriers] ... exhibit significant financial and operational differences in their assets, revenues, and

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[27] These considerations are indistinguishable from the cost considerations and allocation problems faced by the Commission in the regulation of wireline telephony. *See* National Ass'n of Reg. Util. Comm'rs v. FCC, 737 F.2d 1095, 1104 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 1227 (1985).

The requirement of obtaining a reasonable profit is the linchpin of common carrier rate regulation. In exchange for the right to operate a monopoly franchise, common carriers are forced to have their rates regulated. However, those rates cannot be so low that they operate as a confiscation of the regulated entity's property. Smith v. Illinois Bell Tel. Co., 282 U.S. 133, 159-61 (1930). The Office of Advocacy's analogy to local exchange service should not be interpreted to conclude that the Office of Advocacy considers cable operators to be monopolies. In fact, the Office of Advocacy has noted that cable operators face substantial competition in the matter of reexamination of the effective competition standard for the regulation of Cable Television Basic Service Rates, MM Docket No. 90-4, further Notice of Proposed Rulemaking comments of the Acting Chief Counsel at 20-21 (February 14, 1991).

[28] In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order at ¶ 257 (October 4, 1990).

earnings...."[29] Any cursory examination of data on the cable television industry will reveal similar, if not greater, disparities. The Commission should recognize these significant variations in the development of a cost-of-service rate regulatory regime. The first important aspect of this regulation is the development of an appropriate size standard or standards in which to apply cost-of-service rate regulation.

The enormous differences among wireline common carriers has forced the Commission to establish a variety of regulatory mechanisms for local exchange carriers based on size. As a result the Commission mandated price cap regulation for certain local exchange carriers.[30] Local exchange carriers with more than $100 million in gross revenue (so-called Tier 1 carriers) are required to provide the Commission with much more extensive tariff and cost data than smaller carriers.[31] In addition, these Tier 1 carriers are required to provide certain types of interconnection for competing carriers.[32] Finally, Tier 1 local exchange carriers are required to improve their

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[29] *Id.*

[30] In fact, although only the Regional Bell Operating Companies and General Telephone Operating Companies were required to utilize price caps, all local exchange carriers with revenue in excess of $100 million have elected to utilize price caps.

[31] 47 C.F.R. § 32.11(b).

[32] In the Matter of Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, Transport Phase I, Second Report and Order at ¶ 40 (September 2, 1993).

productivity on annual basis at substantially greater rates than smaller carriers.[33]

The Commission also makes distinctions below its Tier 1 classification. The primary demarcation line for carriers below Tier 1 status is whether they have 50,000 subscriber lines. 47 C.F.R. §§ 61.39. A second classification arises from the FCC mandate that carriers with less than $40 million in gross revenue have 9 directors on the board of the NECA. *Id.* at § 69.602(c).

Given the Commission recognition that the substantial differences between large and small carriers necessitate different types of regulation, the Office of Advocacy opines that a similar demarcation should be made in the institution of cost-of-service regulation for cable operators. The Office of Advocacy believes that either the $40 million gross revenue standard[34] or the 50,000 subscriber line (with appropriate translation to a gross revenue as required by the Small Business Act)[35] are appropriate delineations for determining whether a cable operator is small.

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[33] In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Order on Reconsideration at ¶¶ 22-32 (April 17, 1991).

[34] This figure roughly translates to 150,000 subscribers.

[35] Using Commission figures, a cable operator with 50,000 total subscribers would have a gross revenue of approximately $15 million.

Either definition would cover only a small portion of the cable subscribers in the United States. According to the most recent data from the National Cable Television Association, the 25 largest multiple system operators (MSOs) provide service to approximately 80 percent of the homes with cable service. The smallest of those MSOs has a subscriber base in excess of 450,000. Thus, the Advocacy definitions of "small" represent only a small fraction of total cable subscribers and would be reasonably consonant with the concentration of control represented by local exchange carriers.[36]

In previous comments in this docket, the Office of Advocacy noted that most small operators would have substantial difficulty operating under the price cap system. This assertion comports with the Commission's decision not to impose price caps on all local exchange carriers.[37] Since the Office of Advocacy believes that most small operators cannot survive utilizing price caps,[38] most small operators would prefer to utilize

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[36] According to Commission statistics, there are approximately 121 million local telephone lines. Tier 1 carriers control more than 95% of those lines.

[37] The Commission developed a separate incentive plan for small local exchange carriers that attempts to mirror the purported benefits of price cap regulation. 47 C.F.R. § 61.50.

[38] The Commission requests comment on whether a productivity factor should be utilized as part of the price cap system for cable operators -- a concept derived from its price cap regulation of local exchange carriers. The Commission has little data upon which to base the development of a productivity factor other than the data acquired from price cap-regulated local

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conventional cost-of-service regulation. However, the current FCC regulations on cost-of-service are equally onerous on small cable operators. The Commission is required by the RFA to examine ways to reduce those burdens on small cable operators. Again, the Office of Advocacy recommends that the Commission look to its regulation of local exchange carriers for the appropriate model.

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[38](...continued)
exchange carriers. Only one commentator supplied data on a productivity factor and that was for two percent. FNPR at ¶ 320.

Large local exchange carriers supported the use of the same productivity factors required for them under price cap regulation. The Office of Advocacy strongly disagrees. Although the Office of Advocacy recognizes similarities in rate regulation concepts between cable and telephony, substantial differences exist in physical plant and operations. It is very unclear whether the productivity factors for cable operations could currently be derived from those used by local exchange carriers.

Even if the FCC is correct in mandating a productivity factor, the Office of Advocacy does not believe that the productivity factor should be applied to small cable operators. The primary reason for the Commission's establishment of an optional incentive plan for small local exchange carriers was the Commission's belief that these entities could not achieve the productivity reductions of large carriers. In the Matter of Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, CC Docket No. 92-135 at ¶¶ 11-16 (June 11, 1993).

The Office of Advocacy suggests that same assumption is applicable to small cable operators and a productivity factor should not be applied to these operators if they select cost-of-service rate regulation. After the Commission has acquired more data, it may wish to develop an optional incentive regulatory plan similar to the one used by small local exchange carriers.

III. *Average Cost Schedules*

The basic principle of cost-of-service rate regulation is that rates are determined on the basis of costs. *MCI v. FCC*, 675 F.2d 408, 413 (D.C. Cir. 1982). This type of regulation requires the regulator to determine what those costs are. Precise determination of these costs may require extensive data collection, analysis, reporting, and auditing.[39] The Commission has allowed smaller exchange carriers to estimate some or all of their costs through the use of an "average schedule" which adopts general industry data to reflect the costs of a hypothetical company. *National Association of Regulatory Utility Commissioners v. FCC*, 737 F.2d 1095, 1127 (D.C. Cir. 1984), *cert. denied,* 469 U.S. 1227 (1985).

The Commission is currently engaged in an extensive cost study of cable operations. The Office of Advocacy believes that this data will provide the FCC staff with the information needed to construct average cost schedules. The Office of Advocacy reiterates its strong endorsement of average cost schedules because it will substantially reduce burdens on cable operators.

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[39] A cursory examination of the Commission's Uniform System of Accounts aptly demonstrates the complexity associated with tracking costs. This is compounded by the requirement that costs be allocated between the provision of in-state and interstate service as required by the Supreme Court in Smith v. Illinois Bell Tel. Co., 282 U.S. 133, 148 (1930).

In the FNPR, the Commission requests comment on whether average cost schedules should be made available to all operators or only small operators. FNPR at ¶ 333. The Commission has attempted in the past to limit the eligibility of local exchange carriers to utilize average cost schedules to those companies that have less than $40 million in gross revenue. *Alltel Corp. v. FCC*, 838 F.2d 551, 556 (D.C. Cir. 1988) (rejecting as arbitrary and capricious that limitation).

The Office of Advocacy believes that the Commission has two options. First, it can require the largest MSOs to utilize price caps[40] and permit all other companies access to the average cost schedules. This eliminates the problem the Commission faced in *Alltel*. Second, the Commission could limit average cost schedules to small operators (as defined above in Part II C) and develop an adequate justification for that limitation. Given the costs associated with either price cap calculations or cost-of-service showings and the lack of financial resources for many of these smaller operations, the Office of Advocacy believes that the Commission can defend the limitation.[41]

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[40] Again analogizing to wireline telephony regulation, the Commission might require all cable operators with more than $100 million in gross revenue to utilize price caps.

[41] To bolster its defense of the limitation, the Commission may want to seek data on costs associated with calculating rates and associated recordkeeping requirements.

IV. *The NECA Paradigm*

The development of average cost schedules leaves the FCC only one step away from the final element of parallelism with telephony regulation -- the development of a NECA-type organization for cable operators. The average cost schedules for local exchange carriers and associated tariff filings is undertaken by the NECA. 47 C.F.R. § 69.603, .606. The NECA was not formed by local exchange carriers; rather it was established by mandate of the Commission.

An organization could be established at the order of the FCC by the cable operators to provide the same functions for smaller cable operators that the NECA does for local exchange carriers. This organization could provide the administrative assets that most small operators do not have. This organization easily could develop appropriate average schedules, even for a variety of tiers of service,[42] and file those rates with the FCC and local franchise authorities. An even greater benefit would be the ability of the NECA-like organization to develop average schedules for cable operators of varying size.[43] Utilization of these average cost schedules would substantially reduce the

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[42] This would eliminate some of the problems the Commission faces in dealing with rates of a la carte offerings and incentives for acquiring more programs.

[43] This would accomplish one of the primary goals of the RFA -- tiering of regulations to fit the size of the entity.

burdens on the Commission staff.[44] Similarly, the expertise of this organization could ease the review burden on thousands of local franchising authorities by providing concise and easily interpreted information needed to ensure the reasonability of basic service rates. With the establishment of this organization, small cable operators then could devote their resources to system operation, not administrative functions. The ultimate beneficiaries would be customers whose rates would not rise due to increases in administrative costs.[45]

Membership in the organization should not be mandatory but the Office of Advocacy suspects that most small cable operators would willingly join such an association to avoid the enormous responsibilities associated with conventional rate regulation or even average cost schedule regulation. For large operators, their costs, access to capital markets, and ability to utilize

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[44] Instead of reviewing potentially thousands of complaints that cable programming service rates were unreasonable, the Commission would simply have to approve the average schedules developed by the cable version of the NECA as being reasonable (the FCC already has concluded that the same principles apply to basic and cable programming services). Any complaint about rates could be dismissed by the Commission if complainant's operator was charging the average cost schedule rate.

[45] In Alltel Corp. v. FCC, 838 F.2d 551 (D.C. Cir. 1988), Judge Bork noted "[t]he cost of conducting a cost study on certain small carriers is apparently too large to justify incurring it. There is some economy of scale here: as progressively larger carriers are considered, the cost of performing cost studies decreases relative to the benefit provided." *Id.* at 557.

economies of scale militate against their joining such an organization.[46]

In sum, the Office of Advocacy believes that the NECA paradigm has substantial benefits to small entities, customers, and the Commission. The Office of Advocacy urges the FCC to follow the model developed in telephony and establish a National Cable Operator Association (NCOA) similar to NECA.

V. *Conclusion*

The Office of Advocacy commends the Commission for recognizing that small cable operators face a different financial and operational picture than large cable companies. The Office of Advocacy agrees with those commentators that cite the FCC's telephony regulations as the appropriate model for developing a cost-of-service rate regime. However, those commentators did not take the analogy far enough. The Commission has expended significant resources in carrying out its responsibilities under Title II of the Communications Act. The FCC should not abandon that model but should adapt it to the particular vagaries of regulating cable television service.

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[46] A similar analogy can be made to the local exchange carriers operating under price caps and their nonparticipation in revenue pools operated by the NECA. *See* 47 C.F.R. § 61.41.

The Office of Advocacy concludes that appropriate size determinations for small cable operators can be developed if the Commission uses its size standards for local exchange carriers as a basis. The Commission should follow the procedures in the Small Business Act for obtaining approval of the size standard that it develops. The Office of Advocacy also strongly endorses the development of average cost schedules as one of the primary means to reduce regulatory burdens on small operators. Finally, the Office of Advocacy is convinced that the most administratively efficient result is the establishment of a NECA-like organization for cable operators.

Respectfully submitted,

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